RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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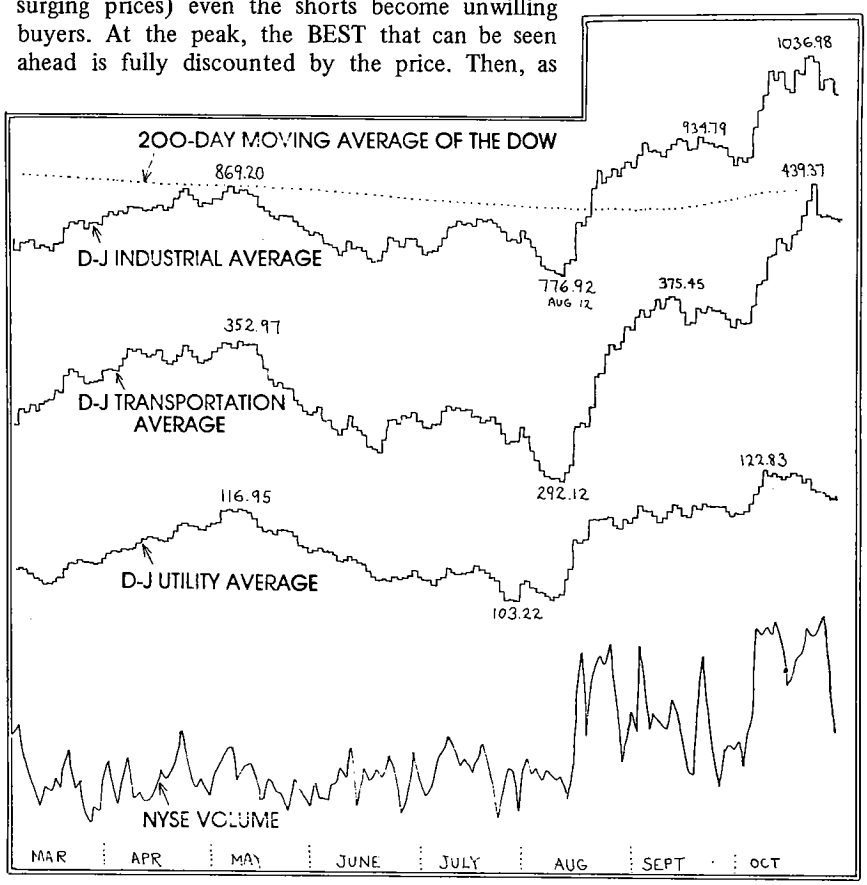
November 3, 1982 **LETTER 847**

Oct. 22, DJIA 1031,36; PTI 1353; A-D Ratio –20.56
Oct. 29, DJIA 991.81; PTI 1355; A-D Ratio –21.15

I note that a number of advisory services are calling it "super-bull" and "mega-bull" already. At the same time, the ranks of the battered bears grow thin. "And you, Russell," I'm asked, "What do you think?" My answer is that I want to see more before making up my mind. What we've witnessed so far has been raw emotion and excitement, and an upward spike in the averages. We've seen the institutions stampede into the markets, we've seen interest rates drop, and we've heard predictions of "Dow 1300 by year-end." My Primary Trend Index (PTI) is holding above its 21-week moving average, and for this reason, if I had to, I'd be a buyer before I was a short seller – but honestly, I want to see more. If there is one lesson I've learned in this business, it's PATIENCE.

The D-J Industrial Average rose almost uninterruptedly from its August 12 low of 776.92 to its October high of 1036.98. The only real pause consisted of a seven-day decline of 38 points during late-September. If you will study the chart on page 2 you will see that the rise in the Dow has assumed the form of a parabolic curve (often termed an exponential rise). During such movements the price structure advances at an ever-increasing rate until, in its late phase, the price is rising vertically.

This vertical rise constitutes the "blow off" phase, and it is here that market action becomes totally one-sided. There are no sellers, only buyers; volume surges as everyone tries to get aboard. The only bears left are the short sellers, and (due to surging prices) even the shorts become unwilling buyers. At the peak, the BEST that can be seen ahead is fully discounted by the price. Then, as the structure forms a spear-point top and falls over, the situation reverses and there are no buyers. Only sellers remain.



FRONT PAGE COMMENT: Making weapons is non-productive. Ultimately you do only one thing with a weapon, you call it obsolete and junk it. A new study shows that for every $1 billion that goes to defense, 18,000 civilian jobs are lost. Yet the US (rightfully or not) is moving towards a major expansion of its military.

Meanwhile, there's a brilliant woman in Washington who has a disconcerting habit of speaking the truth. Her name is Alice Rivlin. This clip contains her latest readings. If Rivlin is right (and I suspect she is), we're in for interesting times ahead. Nothing changes in Washington until a crisis hits. The debt crisis has not hit–yet.

WASHINGTON, Oct. 24 (UPI) — Alice M. Rivlin, director of the Congressional Budget Office, said today that her forecast of budget deficits of $155 billion in each of the next three years "already looks a little optimistic."

The latest forecast by the budget office, she said, "which already looks a little optimistic, projects a steady annual deficit of about $155 billion for 1983, '84 and '85 — not counting approximately $20 billion a year in spending that doesn't show up in the budget."

The director said in an interview in U.S. News & World Report that the large deficits would persist even if the economy enjoyed sustained growth because Federal taxes had been cut more than probable expenditures.

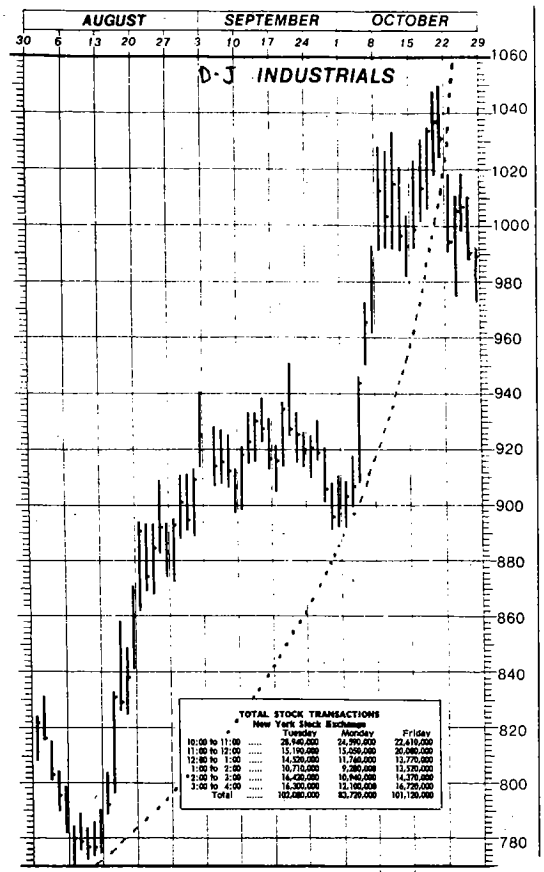
She said further budget-cutting would be difficult because programs for the poor had undergone extensive trimming.

"To make substantial reductions, you have to go after the big growth items that so far have not been touched — defense and Social Security, plus related pensions and Medicare," she added.

In short, when the price goes into a parabolic rise we are seeing a rate phenomenon wherein bullishness reaches incredible proportions. All the buyers attempt to crowd through the doors at the same time, and the result is a vertical spike. This kind of blow-off often ends the bull movements for an extended period of time. I can't prove it, but I'm afraid that is what we may have seen during the August-October period.

Parabolic rises in individual stocks are not common. But a parabolic rise in a stock average such as the D-J Industrial is rare, very rare. The last major parabolic curve we witnessed was the ascent in gold from its 1976 low of 103 to its peak of 850. When that parabola finally broke, gold lost roughly two-thirds of its value.

On October 26 the Dow gapped down and fell out of its parabolic curve. The break was historic, being 36.33 points during a single session. The question, as I write this, is...did the crack of October 26 end the rise which began on August 12 at 776.92? Obviously, I can't tell at this time, but if this parabolic curve runs true to form, then my guess is that the upward momentum has been broken.



This market has avoided any real correction since the Averages turned up on August 12. Therefore, I am particularly interested in seeing what develops in the weeks ahead. Remember, a true correction retraces roughly 1/3 to 2/3 of the previous rise (which in this case is 262 points on the Dow). Time is also an element of importance, and a true correction takes roughly three weeks to as many months.

It is worth noting that the majority of observers now feel the market is overdue for some sort of correction. Therefore, the expectation (from a contrary standpoint) would be for either a sub-normal decline – or the end of the entire rise. I would consider any retreat to Dow 900 or below as bearish. Markets with as much volatility as this one have a habit of producing surprises, so let's watch this one carefully.

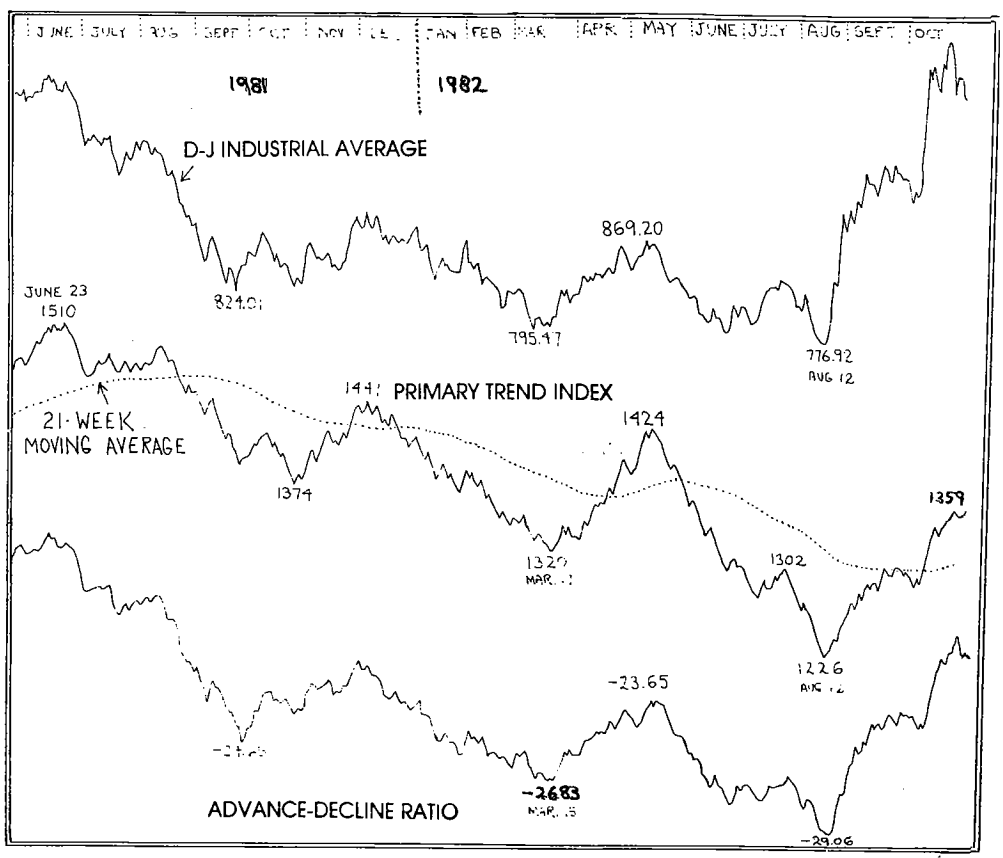
The recent highs were Industrials at 1036.98, Transports at 439.37. It would obviously be impressive to see BOTH of these highs bettered.

Technical observations: On the minus side, the Dow A-D line has not confirmed the rise in the Dow. I feel that this divergence is bringing on the current erratic behavior in the Dow. The negative volume index has not supported the rise, and the index languishes in the vicinity of its August low. Margin accounts have dropped lower over the past four months (they usually rise in a bull market.

On the positive side, the Transports seem very reluctant to decline with the Dow. The A-D ratio on the NYSE has strengthened and has now bettered its December high. Odd lot selling has reached record highs. The PTI has formed a good base (see last Letter).

Turning to the daily PTI chart, we see that the PTI (Primary Trend Index) has risen from its August 12 low of 1226 to last week's high of 1359. The PTI has pushed well above its 21-week moving average, and the MA is now rising. Thus, from the nearer-term standpoint the trend of the PTI is up.

Strangely, (see next section) from the longer-term viewpoint, the PTI has been lagging both the Dow and the A-D ratio. Note that the PTI has not yet even bettered its May high of 1424 – nor has it bettered its December peak of 1447. Thus, I have a long-term pattern in the PTI of lower peaks and lower lows. From a primary trend standpoint, I must therefore say that the PTI is still bearish. Nothing like this divergent action has occurred in the eleven year history of my PTI.



The A-D ratio has been much stronger than the PTI, and it has now bettered both its May and December peaks. Yet never has the PTI lagged so far behind the A-D ratio. It's a puzzle, and the mystery deepens.

PTI: In the Last Letter I included a point & figure chart of the PTI, and I showed that an impressive base had formed. In this report I want to go into a second, but rather disturbing view of the PTI. The page 3 chart shows the PTI (weekly basis) from the period of 1978 to the present. There's a story in this chart, and I think it's well worth noting.

All during the rise from the 1974 lows, the PTI led the way for the markets on

the upside. This is dramatically illustrated by the trendline marked "A" on the chart. Note that the "A" trendline for the Dow actually slanted to the downside during the 1978-80 period. In contrast, the "A" trendline for the PTI sloped sharply upward during the entire period of 1978 through 1981.

This was a bullish situation. It told us that despite the reluctance of the Dow to rise, the market sub-structure (as measured by the PTI) was bullish. No major trouble, I stated repeatedly, has ever occurred while the PTI was walking up a rising trendline.

In 1981 the bull market for the Dow ended. The Dow topped out on April 27 at 1024.05. Two months later, on June 23, the PTI topped out at a value of 1510. What happened after that was most interesting. For the first time in 7 years, the PTI started to act worse than the Dow. The sub-surface technical condition of the stock market was deteriorating.

Compare the angle of descent on the two trendlines marked "B". The PTI trendline declines at a sharper rate. Then note the angle of descent on the trendlines labeled "C". These are the trendlines connecting the bottoms since 1981. Again, it is clear that the PTI is the weaker component.

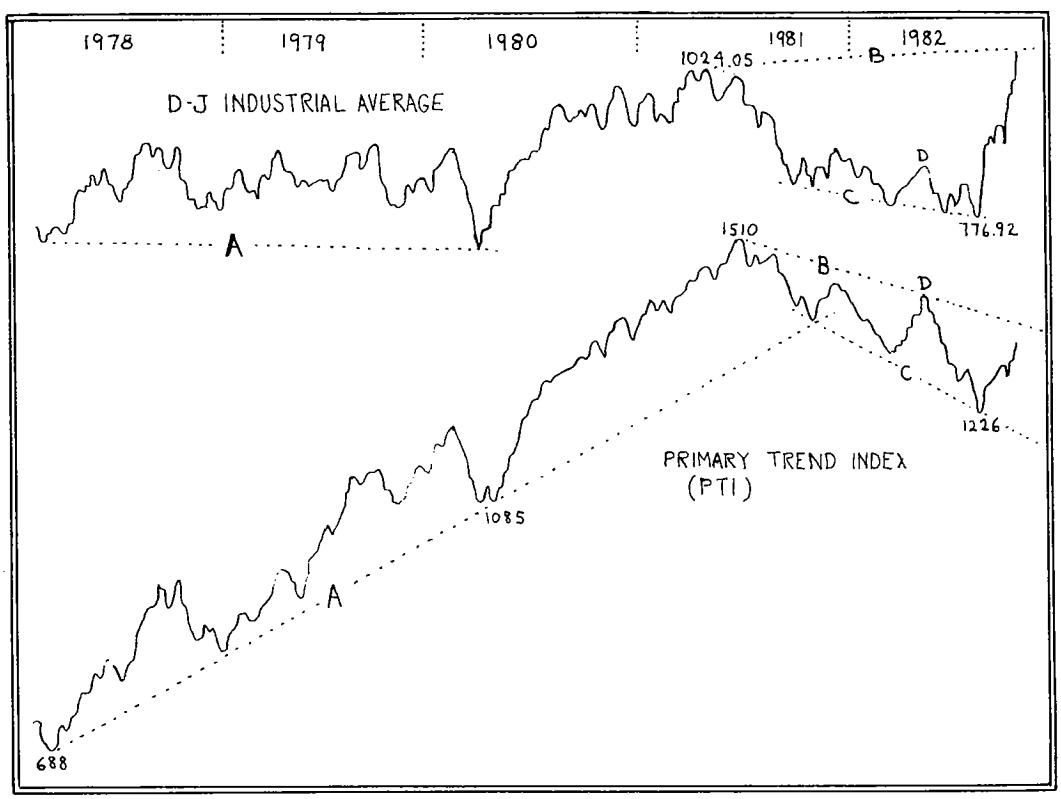
And most dramatic, note in the most recent rally that the Dow rallied far above its May high, a high marked D on the chart. But the PTI pushed up only feebly, and did not get near its own May (D) high.

CONCLUSION: For the first time since 1971 (when I started keeping records of the PTI) the PTI is lagging the Dow on a rise. The PTI is also lagging the A-D ratio on the NYSE. Frankly, I don't know quite what to make of this action. But I do know this. The long-term trend of the PTI leads (or at worst) jibes with the long-term trend of the stock market. If a bull market started on August 12 at 1226 on the PTI, then in due time the PTI will better downward slanting trendline B, and embark on a major trend to the upside. Conversely, if the PTI remains below trendline B then this market is fated to run into trouble (at best, an unprofitable trading range, at worst, a continuation of the bear market).

INVESTMENT POSITION: Volatility on the exchanges is growing. On October 25 the Dow dropped a whopping 36 points. On October 27 the Dow opened up, sank to minus 14 points, then ended up 11 points for a round trip of almost 50 points. What's happening? For one thing, competition among the funds and institutions is intensifying and managers are now trading in-and-out with billions of dollars. Secondly, options are adding volatility to the markets, and traders will often follow the direction of options with actual stock purchases. Thirdly, traders are using combinations of options and stock purchases and sales, in an attempt to beat the market through arbitrage or leveraged operations. Finally, through computers and rapid wire service, dissemination of "news and rumors" is almost instantaneous. Within minutes, thousands of people can react to a news item or a rumor about the Fed or a world political development. All this has led to explosive volatility and record volume on the exchanges.

In my opinion, the volatility of today's markets will lead to increased losses by non-professional traders. And it causes me to be more cautious than ever about my subscribers' money. Remember what I wrote recently about trading: Today you are taking hard (after tax) dollars and trying to make soft dollar profits (profits that will be subject to further taxes). The consequences of losing money in trading becomes onerous under these conditions. You earn $10,000 and are left with $6,000 after taxes, you lose $2,000 in trading and you are left with $4,000 out of your original $10,000. Result: a loss of 60% on your original money.

Thus, preservation of capital becomes crucial in today's difficult environment, and that's what I concentrate on in these Letters. Meanwhile, we have a market that hasn't corrected even though the Dow has run from its bear market low (776.92) to within shooting distance of its record high. Now there's never in stock market history been a move that was not ultimately subject to correction. And its during and after correction that we see what we've got (in terms of the primary direction of the market). So, I advise subscribers to sit tight and avoid trader's itch. Wars come, booms come, depressions arrive, nations rise and fall – but the market is always there, and so are the opportunities.

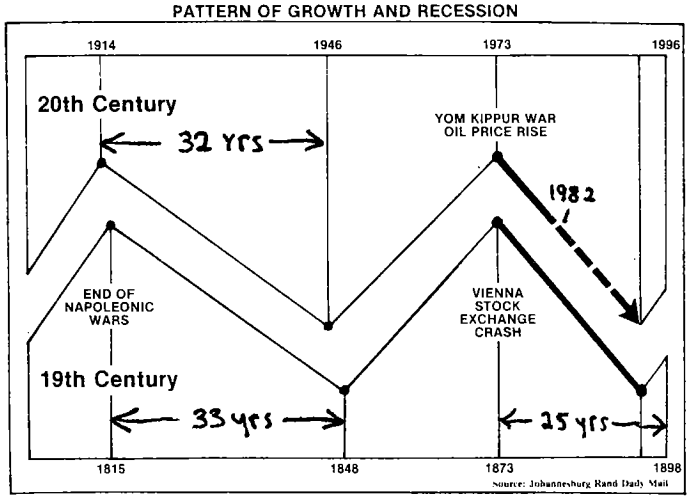


Hold 75% of your liquid assets in T-bills, 25% in 5 to 10 year T-notes and hold a limited position in gold coins and gold stocks (ASA and Campbell Red Lake). The next full correction in the stock market will tell us whether we buy – sit tight on the equity front.

WHAT OF KONDRATIEFF? I must receive 3-4 letters every week asking about the Kondratieff cycle. This is the "long cycle" purportedly discovered by the Russian economist, Kondratieff (he was later sent to Siberia as a reward for his research). The Kondratieff cycle consumes about 54 years, although some observers claim that 50 years is closer to the mark. At any rate, the Kondratieff is the long cycle, and it is a cycle that can be traced back over 200 years.

The existence of this cycle would appear to be based, not only on past case histories, but on common sense. It takes about two generations to run from rags to riches, and it probably takes any nation about the same time to run the course. Then it takes about 25 years or so to work off the preceding excesses, so between the two we get the full 50 year Kondratieff cycle.

PATTERN OF GROWTH AND RECESSION



The last "up-segment" of the Kondratieff cycle started somewhere around the end of World War II, or (as the chart shows it)around 1948. There's not too much argument about the start of the rising cycle, but there is quite a bit of argument about when the up-cycle ended. The chart puts the peak at 1973, and it is probable that the 1973-74 market crash marked the end of the latest rising cycle of Kondratieff.

If so, we have at least 25 years from 1973 to wade through before the cycle ends, and this would take us somewhere near the end of the century. Now admittedly, that's not a very happy prospect, but it is well to remember that a lot can happen within the cycle (after all, the great 1921-29 bull market took place within the down-segment of the last Kondratieff cycle).

"Then what good is the whole Kondratieff thesis?" you ask. And the answer is that it helps to put the picture into context. The post-World War 11 boom probably came to an end around 1973-74, and all the trouble since was to be expected under Kondratieff. The instructive part of the study from this point on is that the cycle of trouble probably will take us to around the year 2000. After that, we should have a euphoric period similar to the late 1940s and 1950s.

Interestingly, we already see one sign of the down-cycle in Kondratieff. That's the return to conservatism, a feeling that the party's over, and now the piper has to be paid. I believe that this sentiment is being translated into the quiet resignation that is accompanying the current 10.1% unemployment. If this high level of unemployment had existed in the 1960s, we would have seen riots throughout the country. Now, despite many predictions of "blood in the streets," we see eleven million Americans unemployed with no riots, no blood, very little protest. I believe it's all part of the mass resignation, the intuitive feeling that the great Kondrateiff wave has turned down. With that downturn, Americans mysteriously sense that we are moving into the period where we must pay for the profligacies of the past 40 years. (Chart courtesy of Johannesburg Publications, Box 11634, Birmingham AL 35202).

DOW: For the past 15 years subscribers have been writing to me stating that the Dow Industrial Average should be adjusted for inflation. Over and over I am asked, "If the Dow was worth 1000 back in 1966, how can it only be worth 1000 today with the dollar valued only at a fraction of its 1966 price?" And my answer has always been, "The Averages automatically adjust for EVERYTHING. They not only adjust for inflation, they adjust for quality of earnings, for the international picture, they adjust for the condition of plant and equipment, they adjust for the effects of taxes on corporations, and on and on."

The fact is that the Dow should be worth a lot more than 1000 today. The Dow should be worth more than it was 16 years ago – but that's not the verdict of the market. In his article Laffer notes that back in 1966 (when the Dow first climbed over 1000) unemployment in the US averaged 3.8%. "Today," he notes, "unemployment is like a disease that is spreading to the economy's central core." Again, in 1966 the Federal budget was "virtually balanced." Today, the Government is $1.1 trillion in debt and facing a new series of massive deficits. "The decline in the real value of equities since 1966," states Laffer," parallels an erratic but relentless deterioration in the state of the US economy."

"What deterioration?" you ask. And I could rattle off a long list which includes high and rising taxes, low productivity, increasing international competition, poor liquidity, rising debt levels, low factory utilization, and so forth. The fact is that there has been vast deterioration in both industry and government in the US. And today's "low" 1000 Dow attests to that fact. If inflation alone was the criterion, then today the Dow could easily sell for 3000 or three times its 1966 price (since the dollar is now worth only one-third of its 1966 value. But inflation alone is not the measure – not by a long shot. I cannot repeat too often that the Averages adjust for everything connected with corporate profits.

NOTES & QUOTES: There's only one sure bet in the world of economics and that is that the debts will grow larger. Between 1971 and 1981 US credit market debt grew from $1.8 trillion to $5.5 trillion. During the same period Free World debt exploded from $3.7 trillion to $14.3 trillion, and interbank Eurocurrency debt rocketed from $6.5 billion to $1.3 trillion.

This mountain of debt represents the mortgaging of many future generations. The result is now apparent – deflation, as the incredible costs of carrying this debt presses the US and world economies to the wall. Can the various nations generate enough *new credits* to carry the current debt? No one knows, but between the Fed, the BIS, the IMF and the World Bank, they're sure trying.

Meanwhile, in the US the monumental resistence to cutting government spending (even while tax receipts fall off due to the recession) is running up record deficits. It is entirely possible that by 1986 we will see the current $1.1 trillion national debt rise 50% to the $1.6 trillion level.

As I see it, the only alternatives are "inflate or die." A moderate amount of monetary inflation (which we are now seeing) is not going to turn the tide and float the debt. It's going to take "big inflation" to keep this economy going – and there's a question of whether the Fed will be willing to go that route.

As far as boosting taxes to reduce or hold the line of government deficits, this approach is producing diminishing returns. And I mean diminishing in terms of economics. Every tax increase now means rising pessimism and less spending on the part of consumers. Thus, the forces of deflation are feeding on themselves, and the Fed and the Administration are forced to confront the great dilemma: "Shall we inflate it or let it languish as it deflates itself?" This drama will assert itself to the fullest extent during 1983, '84 and '85.

* *

The great deception continues. The deception, of course, is that the banks are in good shape. But this clip from the Oct. 26 *NY Times* notes that the US (you and I) are paying the banks the interest on their failing Polish loans. And the excuse, believe it or not, is that if the US didn't pay, then the Poles would default – and such action would let Poland off the hook. Can you believe that logic! Talk about BS . . . . . .

> **At the same time, the White House said that Mr. Reagan would authorize the Government to continue payment of interest owed by Poland to American banks to prevent a default that would relieve Poland of its debt.**
>
> **The White House spokesman, Larry Speakes, said the decision to continue payments to the banks meant that the United States would keep the Poles "on the line, owing the money, and not let them off scot free."**
>
> **The Polish debt to the West is $23 to 24 billion, including $3.2 billion to American banks, according to the Treasury Department.**

* *

On October 26 the Dow fell 36.33 points, the greatest drop (in points) since the 38.33 drop of October 28, 1929, Other massive Dow drops were 34.95 points on May 28, 1962, 31.89 points on Sept. 26, 1955, 30.57 points on Oct. 29, 1929, 29.05 points on Nov. 26, 1973.

On Oct. 27 the *NY Times* published this rundown of historic Dow dates. I thought it was worth including here.

Historic Dates for Dow Average

Here is a chronology of historic dates for the Dow Jones industrials average:

1896: First appears in The Wall Street Journal.

Jan. 12, 1906: Closes above 100 for the first time, at 100.25.

Sept. 3, 1929: Reaches its closing peak for the bull market of the 1920's, at 381.17, less than two months before the Great Crash.

Oct. 28, 1929: Records biggest drop ever, 38.33 points, closing at 260.64.

July 8, 1932: Closes at its Depression low of 41.22, having fallen 89 percent in less than three years.

March 12, 1956: Closes above 500 for the first time, at 500.24.

Jan. 18, 1966: Reaches 1,000 for the first time in mid-session, but drops back to close at 994.20.

Nov. 14, 1972: Closes above 1,000 for the first time, at 1.003.16.

Jan. 11, 1973: Closes at a record high of 1,051.70.

Dec. 6, 1974: Closes at a 12-year low of 577.60, ending the worst bear market since the 1930's.

April 27, 1981: Closes at an eight-year high of 1,024.05.

Aug. 12, 1982: Closes at a two-year low of 776.92, just prior to the start of a historic rally.

Aug. 17, 1982: Rises 38.81 points, to 831.24, in its largest one-day gain on record.

Oct. 25, 1982: Falls 36.33 for its second-largest drop ever.

* *

The NFL football situation is a disaster. The players (all 1500 of them) were averaging $80,000 a year. The owners offered $1.6 billion over five years. By my calculations, that comes out to $213,000 per man, an increase of 188% per man per year. That's a whopping increase. Why didn't the players take it? In my opinion, they have rotten leadership, and moreover, they didn't understand the meaning of the offer. Mr. Garvey, the union leader, is on an ego trip, and I believe he wants to make a name for himself.

The owners, all of them wealthy (some inherited and some of it self-made) are rugged individualists, capitalists in the classic sense of the word. They are standing fast, rather than let the union tell them how to run their business. The result: a financial disaster for the players. The average NFL player plays for about 4.5 years. Thus, if this season is lost (and it probably is) about 25% of their lifetime football money will go down the drain.

Last week San Diego Charger owner Gene Klein said, "The players don't realize that the odds are substantial that there will be no season. But I guarantee we will open camp in 1983 with the people we have under contract who want to play and any others . . . . who desire to play in the NFL." It looks like the current players who hold out will end up like the air controllers– out of work for good.

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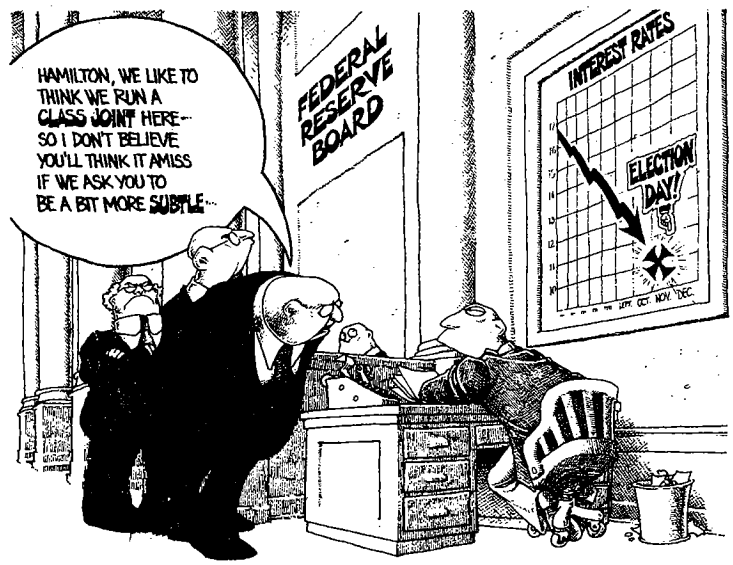
Sadly, not all the cartoonists believe that the Fed's monumental switch on policy was non-political. This cartoon attests to that.


HAMILTON, WE LIKE TO THINK WE RUN A CLASS JOINT HERE-- SO I DON'T BELIEVE YOU'LL THINK IT AMISS IF WE ASK YOU TO BE A BIT MORE SUBTLE--
FEDERAL RESERVE BOARD
INTEREST RATES
ELECTION DAY!

* *

I just got off the phone with Elliot Janeway, who is out here to address a group at Newport Beach. "What do you think of Reagan?" I asked the great one. "Dick, there is no Ronald Reagan," he snapped, "He's simply a figment of the conservative imagination." "Can I quote you on that?" I asked. "Sure," he said. I am.

* *

From Russell's Consumer Dept: If you have an extra room or a large space in one room, and you happen to like TV movies or sports (or TV in general), let me recommend the Kloss Novabeam Model One. This is a giant 6.5 foot screen (measured diagonally). Henry Kloss (formerly top man at KLH and then

Advent) is an inventing genius, and he has developed a projection TV which is just great. I admit that I love it. The Kloss is a different experience than ordinary TV – you think you're seeing a motion picture in your home.

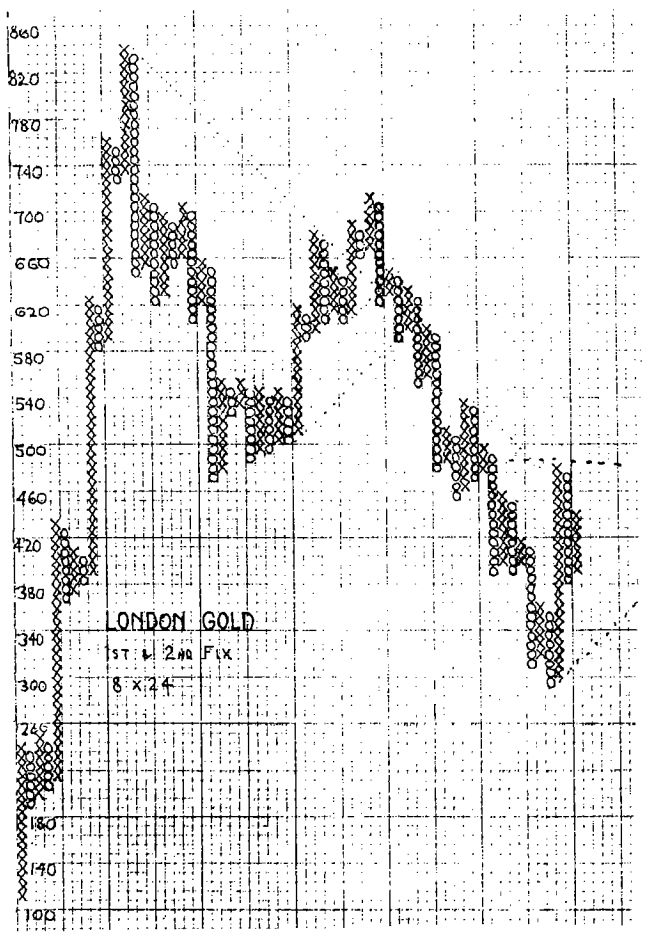
Now Kloss has a new TV, a projection (5 foot) that allows you to project the picture on your white wall. I have not seen this new Novabeam Two, but I'll bet it's a winner. Price for the Novabeam One, about $3,000, for the Two about $2,200. Kloss Video, 145 Sidney St., Cambridge, Mass. 02130.

* *

The Social Security controversy is moving out of the argument and babble stage; it's moving into the area where action must be taken – or the system will go bankrupt. Most people know that, but they're reluctant to face it. The politicians know it, but they don't want to hear it. Columnist William Safire of the NY Times knows it, and Safire is never afraid to speak out. This is from his October 21 column:

"The next time your hand is grabbed by a candidate, ask the unaskable. Do you favor tax increases or benefit limitation to pay for Social Security? If he takes the position you like, vote for him. If he ducks the subject, giving the usual mush about waiting for somebody else's recommendations for 'reform', grab your hand back – we don't need more wimps in Congress."

GOLD: Private banks here and abroad have loaned $300 billion to governments of developing Eastern European countries. Countries such as Argentina, Mexico, Poland are unable to pay the interest. Bank liquidity in the US and abroad is very thin.



It's hard to believe, with this much smoke visible, that there will be no fires. This is doubly true since the world's answer to piled up credits is more credits – credits to pay interest, credits to feed the hungry, credits to finance military expansions, credits to refinance credits. It's the biggest financial balancing act in world history.

Gold pops and sinks with every new rumor. But basically, I feel the following is true: (1) Gold recorded its bear market low of 297 last June. (2) Gold has looked bullish ever since. (3) Gold, once having risen above its 50-week moving average, has never dropped below it.

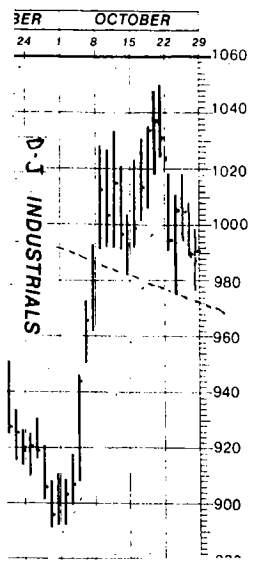
The 50-week or primary moving average for gold was 391 last week. The 13-week MA was 409. The sensitive 5-week MA was 423. The moving average studies remain in the bullish mode.

I have included my point & figure chart of gold (each box on the chart equals 8 points, and only advances or declines of 24 or more points are depicted). My guess here is that gold has formed a huge head-and-shoulders bottom pattern. The right shoulder of the pattern has become a trading range with a high at 480 and a low of 388. The odds are the gold will ultimately break out of this range on the high side. Any move above 480 should send gold into the 550-575 range.

But gold is aware of the opposing forces of world inflation and deflation. Gold knows that the mile-high debts of the world are a force for deflation, and gold knows that the new credits being issued (in order to hold up this debt) are inflationary. It's a grim struggle and its unlikely to be settled anytime soon. But gold knows one thing – mild inflation is not going to turn the US economy up. It's going to take hyper-inflation this time around.

The days in which "a little juice will really produce" are over.

LATE NOTES: Over the past three weeks a potential head-and-shoulders top pattern has formed in the Dow, as you can see from this little daily Dow chart. The support line (dashed line on the chart) comes in at about 970, so any close which takes the Dow decisively below the 965-970 area should complete the top.



The first major downside correction will provide us with vital information about this market. Up to this point, the market has resisted all attempts to correct.

FOR NEW YORK SUBSCRIBERS: In accordance with the New York Investment Advisers Act, we have filed our Investment Advisor Statement and New York subscribers may obtain a copy of same upon request. A fee of $14 will be charged for xerox costs.

NEXT MAILING: November 17